Letter Report: Write-off of Taxes Owed Resulted in Inequitable Treatment of Taxpayers

August 2001

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

August 31, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Pamela J. Gardiner

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - Write-off of Taxes Owed Resulted in Inequitable Treatment of Taxpayers

This report presents the results of our review to determine if the Automated Collection System (ACS) inventory transition adversely affected the collection of outstanding taxes, protection of the government's interest, and the taxpayers' future compliance with tax laws.

In summary, we found taxpayers did not receive consistent treatment when the IRS wrote off their taxes owed in its effort to reduce the ACS inventory. Specifically, some taxpayers had liens filed against them to protect the Government's interests, while other taxpayers received an unwarranted break because liens were not filed.

We recommended the IRS identify and review all cases automatically removed from the ACS inventory that met the required lien filing criteria to ensure liens were filed when appropriate. In addition, it should ensure proper lien filing procedures are followed for future cases removed from the ACS inventory, employees receive refresher training on lien filing procedures, and managers institute quality review steps to ensure that lien filing procedures are being properly followed.

Management's response was due on August 27, 2001. As of August 29, 2001, management had not responded to the draft report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or M. Susan Boehmer, Acting Assistant Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

Objective and Scope

The audit objective was to determine if the ACS inventory transition adversely affected the collection of outstanding taxes, the protection of the government's interest, and the taxpayers' future compliance with tax laws.

This audit was initiated as part of the Treasury Inspector General for Tax Administration's (TIGTA) coverage to assess the Internal Revenue Service's (IRS) reorganization efforts. The overall objective of our audit was to determine if the Automated Collection System (ACS) inventory transition adversely affected the collection of outstanding taxes, protection of the government's interest, and the taxpayers' future compliance with tax laws.

To accomplish our objective, we:

- Used a computer program to identify and analyze the population of 182,585 taxpayer accounts removed from the ACS inventory during the period of June to December 2000. From this universe we selected 2 judgmental samples totaling 150 cases and determined whether lien procedures were properly and consistently followed.
- Interviewed employees from the Wage and Investment Division's Compliance and Remote Collection functions and the Small Business/ Self-Employed Division's Compliance Center Collection function, ACS service center processing units, and ACS collection sites.[1]
- Selected a judgmental sample of 554 ACS cases from the total inventory on hand at the time of our field visits at two collection sites (Brookhaven and Buffalo) and determined if the cases were moved to the correct call sites based on the type of taxpayer owing the liability.
- Reviewed training documentation at the Brookhaven and Buffalo call sites and determined whether

[1] ACS sites included Atlanta, Austin, Buffalo, Fresno, Jacksonville, Kansas City, and St. Louis.

employees were adequately trained to work the type of ACS cases they were assigned.

We performed audit work at the Brookhaven and Andover tax processing centers and at the Buffalo ACS collection site. In addition, contacts were made with Atlanta, Austin, Dallas, Fresno, Seattle, Kansas City, Jacksonville, and St. Louis call sites. The audit was conducted from October 2000 through March 2001 and in accordance with *Government Auditing Standards.* Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

The IRS Restructuring and Reform Act of 1998 (RRA 98)[2] directed the IRS Commissioner to reorganize the IRS into units serving groups of taxpayers with similar needs. It also stressed that the reorganization should not affect the integrity of legal documents or interfere with any proceedings in effect before the reorganization. On October 1, 2000, the four new IRS business units were in place to begin serving groups of taxpayers with similar needs. In the IRS' efforts to reorganize the ACS, it divided the ACS collection sites and inventory on hand between the two new business units serving individual taxpayers and small business owners.

In October 2000, the IRS divided its ACS call sites and inventory by the type of taxpayer owing the liability.

The ACS is a telephone-based collection system with a core mission to promptly collect taxes owed. The IRS attempts to contact taxpayers by telephone and/or correspondence in an effort to collect the taxes owed. Success is achieved through promptly assisting taxpayers that want to pay the taxes owed or identifying solutions when they cannot pay. Actions are also taken against those taxpayers that do not want to pay.

[2] Pub. L. No. 105-206, 112 Stat. 685.

The IRS can file tax liens against those taxpayers that do not want to pay their taxes owed.

If a taxpayer will not pay his or her taxes owed, the IRS can file a federal tax lien. A tax lien is a legal claim to the taxpayer's property as security or payment of his or her taxes owed. A tax lien notifies creditors that there is a claim against the taxpayer and his or her personal property. If the taxpayer sells the property, the IRS has secured the right to collect funds from the sales proceeds to pay the taxes owed. In Fiscal Year (FY) 2000, the IRS filed 141,049 liens through the ACS and protected a minimum of $705 million[3] in taxes owed. In addition, taxes collected during FY 2000 from ACS liens filed during either FY 2000 or prior totaled over $20 million.

In an effort to reduce overage inventory, the IRS instituted a procedure that automatically closes older cases out of inventory on a weekly basis.

Since FY 1997, a reduction in the number of employees working in the ACS along with increased incoming telephone calls has resulted in the ACS inventory swelling, with the IRS unable to timely work cases. In an effort to reduce its older inventory and more promptly collect outstanding taxes, the IRS instituted a process that automatically removes cases from inventory on a weekly basis.

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In a memorandum dated August 2000, an IRS executive cautioned the ACS managers that the automatic closing of cases should not affect the protection of the government's interest in taxes owed. Adequate consideration must be given to filing a lien on those cases where taxes owed are $5,000 or more.

During the period June to December 2000, over 182,000 taxpayer cases were automatically closed out of the ACS inventory with taxes owed totaling over $1 billion dollars.

Through a computer extract, the TIGTA identified that during the period of June to December 2000, a total of 182,585 taxpayer cases were automatically closed out of the ACS inventory, with taxes owed in excess of $1 billion. The following table provides a breakdown of the number of cases automatically closed out of the ACS inventory and whether they met the $5,000 threshold for filing a lien.

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[3] The IRS does not capture information as to the amount of taxes owed protected by liens filings; therefore, we computed the amount using a minimum $5,000 owed for each lien.

**Automatic Case Closures From the ACS Inventory
June to December 2000**

	Total Cases	Percentage
Taxes Owed Over $5,000	88,879	49%
Taxes Owed Less Than $5,000	93,706	51%
Totals	182,585	100%

Source: TIGTA extract from the IRS Masterfile for the period June to December 2000.

Of the 88,879 cases with taxes owed over $5,000, our extract identified that 31,536 of these taxpayers had a lien filed, with the remaining 57,343 having no tax lien filed with taxpayers owing an estimated $502 million in taxes.

Results

Inconsistent taxpayer treatment and the inability to protect an estimated $500 million in taxes owed resulted from the IRS not filing required liens on an estimated 57,343 taxpayer cases.

The IRS was successful in moving its inventory to the appropriate ACS collection sites and training its employees to work those cases. However, taxpayers who owed at least $5,000 were not treated consistently when the IRS removed their cases from its inventory. Specifically, an estimated 57,343 (64 percent) of the 88,879 taxpayers who owed taxes of $5,000 or more received an unwarranted break because tax liens were not filed. By not filing the tax liens, the IRS (1) provided inconsistent treatment to the 88,879 taxpayers who met IRS guidelines for lien filing consideration and (2) chose to not protect an estimated $500[4] million in taxes owed.

In contrast, the remaining 31,536 taxpayers had liens filed and will be required to pay off their taxes owed before the liens are released.

[4] Computed by taking the total taxes owed by the 57,343 taxpayers of $502 million less the cost to file liens against the 57,343 taxpayers of $1.7 million (see page 11).

Increased incoming and outgoing telephone demand has contributed to an increase in the ACS case workload. As a result, the number of old cases that are not being timely worked and resolved, and eventually automatically removed from the ACS inventory, continues to increase.

Taxpayers Were Not Treated Consistently When Their Taxes Owed Were Written Off

Our analysis of IRS data identified 88,879 taxpayers who owed at least $5,000 were not treated consistently when the IRS removed their cases from its inventory. As a result, the IRS chose not to protect the government's interest in over $500 million in taxes owed by these individuals. The IRS' inconsistent treatment of taxpayers was a complaint during the 1997 hearings before the Congress on IRS abuses and contributed to the subsequent passing of the RRA 98.

IRS guidelines require a lien to be filed when no personal contact is made with a taxpayer whose taxes owed are $5,000 or more.

IRS guidelines require the ACS employees to review all cases where taxpayers owe more than $5,000 in tax to determine whether a lien should be filed against the taxpayer before the case is closed. If the employee decides that a lien should not be filed, he or she must document the reason for not filing a lien in the ACS case file. For those cases where taxpayers owe more than $5,000 and the ACS employees are not successful in personally contacting the taxpayer, a lien should be filed before the case is closed.

The IRS could not provide the case documentation for 11 cases so that the TIGTA could determine whether the IRS employees conformed to lien filing guidelines.

To assess conformance with the IRS' lien filing guidelines, we reviewed a judgmental sample of 100 cases closed out of inventory with no lien filed and the taxpayer owing at least $5,000 in taxes. For 11 cases, the IRS was unable to provide case documentation so that we could determine if lien procedures were followed. The IRS could not provide a reason as to why the case documentation could not be located for these 11 cases.

For the remaining 89 cases we reviewed, we found that in 83 percent the IRS had no personal contact with the taxpayer prior to closing the case, as follows:

	No Lien Filed
Personal Contact Made	15
No Personal Contact	74[5]
Total	89[6]

For the 15 cases where personal contact was made, the required explanation was not provided in the case history as to why a lien was not filed.

To further evaluate the IRS' consistency and conformance with lien filing procedures, we reviewed an additional judgmental sample of 50 cases where the IRS filed a lien and taxes owed were at least $5,000. These cases were reviewed to determine if the IRS employees filed liens against taxpayers for which they had no personal contacts as required. For the 50 cases we found the following:

	Lien Filed
Personal Contact Made	08
No Personal Contact	42
Total	50

The TIGTA case analysis identified that taxpayers were not treated consistently concerning the required filing of liens when the IRS is unable to personally contact a taxpayer.

Our analysis of the two samples confirmed that taxpayers were not treated consistently concerning the required filing of liens when the IRS is unable to personally contact a taxpayer. Specifically, in the first sample, 74 of the 89 cases had no personal contact with the taxpayer; however, a lien was not filed as required before closing the case. In comparison, 42 of the 50 cases in the second sample with no personal contact with

[5] IRS guidelines require a lien to be filed when no personal contact is made with the taxpayer.

[6] IRS guidelines require a lien to be filed when no personal contact is made with the taxpayer.

the taxpayer had a lien filed before closing the case. (See Attachment IV for examples of these inconsistencies.)

Inconsistent filing of liens and nonconformance with lien filing requirements resulted from IRS management not ensuring that employees consistently followed the proper procedures to file liens when working to close the older tax cases. In responding to our concerns regarding inconsistent treatment of taxpayers, IRS management explained that the lack of lien filing uniformity is unclear; however, the IRS intends to treat the lien filing problem as one of training and take appropriate action to correct the deficiency.

Recommendations

The Commissioner, Wage and Investment Division, should:

1. Identify and review all cases automatically removed from the ACS inventory that met the required lien filing criteria to ensure liens were filed when appropriate. In addition, ensure proper lien filing procedures are followed for future cases removed from the ACS inventory.
2. Ensure that employees receive refresher training on lien filing procedures and that managers institute quality review steps to ensure that lien filing procedures are being properly followed.

<u>Management's Response</u>: Management's response was due on August 27, 2001. As of August 29, 2001, management had not responded to the draft report.

Conclusion

While the IRS took positive steps to clean up its older ACS inventory, it did not effectively manage the removal of the older cases.

Increased incoming and outgoing telephone demand has contributed to an increase in the ACS case workload. As a result, the number of old cases that are not being timely worked and resolved and eventually automatically removed from inventory continues to increase. Therefore, it is imperative that consistent lien filing procedures are followed to ensure that taxpayers are treated consistently and the tax revenues are protected.

Appendix I

Major Contributors to This Report

Walter E. Arrison, Assistant Inspector General for Audit (Wage and Investment Income Programs)
Michael Phillips, Director
Russell Martin, Audit Manager
Kenneth Forbes, Senior Auditor
John Piecuch, Senior Auditor
Roberta Bruno, Auditor
Mary Keyes, Auditor
Keith Koller, Computer Systems Analyst

Appendix II

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Appendix III

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:
- Protection of Revenue – Potential; $500 million (see page 5).

Methodology Used to Measure the Reported Benefit:
We computed total potential revenue protected of $500 million as follows:

• Total cases closed during the period June to December 2000 with an aggregate balance of $5,000 or more in taxes owed	57,343
• Total liabilities owed by the 57,343 taxpayers	$502 million
• (Less) Cost of lien filings for 57,343 taxpayers[1]	($1.7 million)
• Total Potential Revenue Protected	$500 million

[1] Cost of lien filing $30 multiplied by 57,343 = $1.7 million.

Appendix IV

Case Examples: Inconsistent Treatment of Taxpayers Regarding the Filing of Liens When There Is No Personal Contact and Taxes Owed Are Greater Than $5,000

Case Scenario: #1

Taxpayer A		**Taxpayer B**	
Tax period:	1989	Tax period:	1993
Date assigned ACS[1]:	03/22/99	Date assigned ACS:	07/05/99
Taxes owed:	$7,029	Taxes owed:	$8,138
Taxpayer contacted?	No	Taxpayer contacted?	No
Was lien filed?	Yes	Was lien filed?	No
Date filed:	08/08/94		
Date case closed:	09/11/00	Date case closed:	10/02/00

Case Scenario: #2

Taxpayer C		**Taxpayer D**	
Tax period:	1989	Tax period:	1991
Date assigned ACS:	05/31/99	Date assigned ACS:	04/20/98
Taxes owed:	$5,464	Taxes owed:	$5,548
Taxpayer contacted?	No	Taxpayer contacted?	No
Was lien filed?	Yes	Was lien filed?	No
Date filed:	5/16/97		
Date case closed:	09/11/00	Date case closed:	09/25/00

[1] Date of most recent assignment to the Automated Collection System (ACS). As delinquencies occur, cases can drop out and/or be reassigned to the ACS multiple times.

Case Scenario: #3

Taxpayer E		**Taxpayer F**	
Tax period:	1992	Tax period:	1997
Date assigned ACS:	06/14/99	Date assigned ACS:	05/17/99
Taxes owed:	$5,400	Taxes owed:	$7,866
Taxpayer contacted?	No	Taxpayer contacted?	No
Was lien filed?	Yes	Was lien filed?	No
Date filed:	06/05/95		
Date case closed:	07/17/00	Date closed:	09/25/00